

AMOCO PRODUCTION CO.

IBLA 77-18

Decided March 25, 1977

Appeal from decision of GS-78-O & G of the Acting Director, Geological Survey, establishing a different basis for computation of the Government's royalty from oil and gas leases NM 0498 and 01140.

Affirmed.

1. Oil and Gas Leases: Royalties

In determining the amount of royalty due to the United States from an oil and gas lease, it is proper for the Geological Survey to use a base value which includes both the purchase price paid for the natural gas plus any additional sum paid by the purchaser of the gas to the seller as consideration for the purchase of gas.

APPEARANCES: R. H. Landt, Esq., Amoco Production Co.; Frederick N. Ferguson, Esq., Assistant Solicitor, Minerals, Department of the Interior, Washington, D.C., for the Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE RITVO

Amoco Production Company has appealed from decision GS-78-O & G of September 20, 1976, wherein the Acting Director, Geological Survey, affirmed the basis of royalty computation prescribed for oil and gas leases NM 0498 and NM 01140, San Juan Area, New Mexico, set out in the advice to Amoco, contained in the Acting Area Petroleum Accountant's letter of February 6, 1975. That letter stated that tax reimbursements paid a lessee by the purchaser of leasehold production are considered to be part of the gross proceeds to the lessee.

Both appellant and the Geological Survey agree to the facts of this case. Appellant is reimbursed by its purchaser for certain payments which it makes to the state of New Mexico as a tax on production from Federal oil and gas leases. Purchaser reimburses the producer for 100 per cent of the tax paid, however tax is paid on

seven-eighths of production, i.e., tax is not paid on the one-eighth share which goes to the United States as royalties. Appellant has not included the amount received as reimbursement as part of its "gross proceeds" or as part of the "value" of it uses to compare the royalties due to the United States on its leasehold.

The State of New Mexico levies a severance tax on oil, natural gas and liquid hydrocarbon severed from the soil, within the state 72-19-1 et seq. New Mexico Statutes, Annotated, as amended, and supplemented. The present tax is at the rate of 3-3/4 percent of the taxable value of said products, effective July 1, 1974. 72-19-4. New Mexico Statutes Annotated, as amended and supplemented. Payment of the tax is the responsibility of the interest owner to the extent of his interest in the value of such products, or to the extent of his interest as maybe measured by the value of such products. 72-19-4 New Mexico Statutes Annotated, as amended and supplemented.

[1] The issue presented is whether the amount reimbursed by the buyer of leasehold production to the lessee for severance tax paid by the lessee on such production is properly to be included as part of the basis used to compute the royalties due the United States on the leasehold production.

The Board has recently fully considered this issue and has held a reimbursed severance tax is to be added to the selling price to determine gross proceeds received by the lessee. Knife River Coal Mining Company, 29 IBLA 26 (1977); Wheless Drilling Company, 13 IBLA 21, 80 I.D. 559, (1973). The holdings and reasoning in those cases are fully applicable to the facts here.

Leases NM 0498 and 01140 are noncompetitive and "are conditioned upon the payment by the lessee of a royalty of 12-1/2 percentum in amount as value of the production removed or sold from the leases." 30 U.S.C. § 226(c) (1970).

The oil and gas operating regulation 30 CFR 221.47 states:

The value of production, for the purpose of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purpose of computing royalty be deemed less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit values shall have been determined by the Secretary. In the absence of good

reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like-quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value. [Emphasis supplied.]

In its statement of reasons, Amoco argues that the regulation governing royalty valuation (30 CFR 211.47) in effect allows the Federal government to collect a royalty in excess of 12-1/2 percent on production from a noncompetitive lease, and, therefore, is inconsistent with the statute (30 U.S.C. § 226(c) (1970)). The statute requires "a royalty of 12-1/2 percentum in amount or value of the production removed or sold" from a noncompetitive lease, whereas the regulation requires that "[under no circumstances shall the value of production * * * for purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof * * *." As conceded by Amoco in its statement of reasons, the Secretary is given considerable latitude in determining what is the "value" of the production from a lease. The Secretary has properly exercised that discretion by issuing 30 CFR 211.47, which requires that the value of production for royalty purposes be at least equal to the gross proceeds accruing to the lessee upon sale of the output of the lease. Wheless Drilling Company, *supra*, at 604; Kerr-McGee Oil Industries, Inc., 70 I.D. 464 (1963). See also California Company v. Udall, 296 F. 2d 384 (D.C. Cir. 1961). Therefore, there is no inconsistency between the statute and the regulation.

The price received by appellant is that set by the Federal Power Commission. In addition, by virtue of its gas sales arrangements with its purchaser and by virtue of the Federal Power Commission's Opinion No. 699-D issued October 9, 1974, Amoco has been permitted to collect from its purchaser those certain State taxes on its portion of the production but not those taxes that were never levied nor paid on the portion of the United States.

We recognize that authority to set field prices for natural gas sold in interstate commerce is vested in the Federal Power Commission, by virtue of the Natural Gas Act, 15 U.S.C. § 713 et seq. (1970). We recognize also that the field price established by the FPC is not necessarily the "value of production" as that term is used in the oil and gas operating regulations, 30 CFR 221.47, especially when the additional factor "gross proceeds" is considered. Wheless Drilling Company, *supra*. Proceeds and fair market value may not be interchangeable. Proceeds of a sale, unless there is something in the context showing to the contrary,

means total proceeds. United States v. Stanolind Crude Oil Purchasing Company, 113 F. 2d 194, 198 (10th Cir. 1940).

In computing the royalty due to the United States under a lease the Secretary of the Interior may look to the actual consideration received by the lessee-seller under gas sales contracts with a buyer in order to determine the proper value basis for the royalty. Kerr-McGee Oil Industries, Inc., supra; Wheless Drilling Company, supra.

Appellant's argument that the tax reimbursement is not "accruing" to the lessee as that word is used in 30 CFR 221.47, but is either merely funneled through the lessee to the state or paid directly to the state, is a variation on a theme which has been used in similar instances and rejected there also. 1/ Most likely appellant would admit that someone must pay the New Mexico severance tax. Were it not for the reimbursement clause, the appellant would pay the tax out of its own pocket. In any case the appellant is liable for the severance tax to the State of New Mexico. 72-19-4, New Mexico Statutes, Annotated, as amended and supplemented. When appellant is being reimbursed for a tax it is being relieved of an obligation for which it is liable. To say this assumption of a liability by the buyer is not proceeds to the seller because it does not get to keep the money is to ignore the fact the lessee-seller does not have to reach into its own pocket to pay the severance tax liability. Wheless Drilling Company, supra; Knife River Coal Mining Company, supra. 2/

1/ In federal income taxation the general principle is that if the taxpayer procures payment directly to his creditor of money due the taxpayer, he does not escape taxation merely because he did not actively receive the money. Helvering v. Horst, 331 U.S. 112, 116, 61 S. Ct. 144, 85 L. Ed. 75, 131 A.L.R. 655 (1940); United States Steel Corporation v. United States, 270 F. Supp. 253 (1967). See also Commissioner of Internal Revenue v. Lester, 366 U.S. 299, 81 S. Ct. 1343, 6 L. Ed.2d 306 (1961); commissioner of Internal Revenue v. Fender Sales, Inc., 338 F. 2d 924 (9th Cir. 1964); Shaw Construction Co. v. Commissioner of Internal Revenue, 323 F.2d 316 (9th Cir. 1963).

In cases where it was necessary to determine if payment of Minnesota ad valorem taxes were part of the rent, it was held payment by a lessee of the Minnesota ad valorem tax for lessor, constituted additional rent. United States Steel Corporation v. United States, supra; Handelman v. U.S., 357 F. 2d 694 (Ct. Cl. 1966).

2/ A similar allegation was discussed in Kerr-McGee, supra, at 470.

"* * * To say that the reimbursement for additional royalty is not part of the 'gross proceeds' to be received under their contracts

As the Board said in Wheless, supra:

It seems obvious to us that the buyer thus is paying to the seller an amount greater than the established field price for its natural gas purchases. * * * It follows therefore that it is reasonable to compute the Federal royalty on the natural gas taken on a unit value consisting of the field price established by the Federal Power Commission plus the amount of severance tax reimbursed by the buyer.

Amoco argues that by assessing a royalty on the severance tax rebate, the Survey is requiring an unlawful rebate under the lessee's effective FPC rate. Opinion No. 699-D, 52 FPC 915 (1974), held that "it is proper * * * for producers to adjust the national rate upward for a state ad valorem tax where such tax is based on production factors." 52 FPC at 915-16. The FPC thus explicitly allowed producers to include the severance tax as part of the price paid on production. The Survey is merely assessing royalties on the price received by Amoco as set by the FPC. It is not attempting to value the gas for royalty purposes at a level in excess of the FPC price. At any rate, the Survey is not bound by the FPC price in assessing royalties on gas, if the gross proceeds accruing to the lessee exceed that price. Wheless Drilling Company, supra at 603-604.

Finally, Amoco argues that the tax rebates do not "accrue" to the lessee because they are immediately paid to the State. The statutory requirement to assess a royalty on the value of the production from the lease is not concerned with how the proceeds from the sale are allocated by the lessee. Whether used to pay severance taxes or workers' salaries, the proceeds from the sale of the gas are subject to the 12-1/2 royalty rate.

Appellant's request for oral argument is denied because their brief was sufficient to understand fully its position.

fn. 2 (continued)

would not be realistic, for if there were no reimbursement provision the lessees would still have to pay the additional royalty, taking it out of their working interest share of the production. With the reimbursement provision they are receiving an additional compensation for the production from the leases. The practical result of appellants' contention would be that they, rather than the United States, could determine the value of production simply by allocating the value they will receive under different categories designated as being other than the 'price,' yet all relating to the production. There is nothing in the Act or its legislative history which would suggest that this was intended.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Martin Ritvo
Administrative Judge

We concur:

Frederick Fishman
Administrative Judge

Anne Poindexter Lewis
Administrative Judge

